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The high poverty rate in Mexico depresses the development of human capital and creates a population vulnerable to organized crime and cartels. Remittances, Mexico's second largest source of foreign income, offer opportunities to the low-income families that receive this money. The government of Mexico has enacted a "Tres por Uno" program in an attempt to magnify the impact of these remittances on local communities, but this plan has proven largely ineffective at decreasing poverty due to arguments over project selection and a lack of project sustainability. Instead, the government should take a lighter hand and strive to shape, rather than direct, how its population uses remittances. The Mexican government should encourage the individual investment of remittances through improving its domestic banking infrastructure and incentivizing investment in small businesses in order to reduce its national asset-based poverty rate.

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**NAVAL WAR COLLEGE**
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**Unlocking the Power of Remittances in Mexico: Keys to a Government Strategy for Poverty Reduction**

**by**

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**A paper submitted to the Faculty of the Naval War College in partial satisfaction of the requirements of the Department of Joint Military Operations.**

**The contents of this paper reflect my own personal views and are not necessarily endorsed by the Naval War College or the Department of the Navy.**

**Signature: ______________________**

**28 October 2011**

## Contents

## Abstract

The high poverty rate in Mexico depresses the development of human capital and creates a population vulnerable to organized crime and cartels. Remittances, Mexico's second largest source of foreign income, offer opportunities to the low-income families that receive this money.  The government of Mexico has enacted a "Tres por Uno" program in an attempt to magnify the impact of these remittances on local communities, but this plan has proven largely ineffective at decreasing poverty due to arguments over project selection and a lack of project sustainability.  Instead, the government should take a lighter hand and strive to shape, rather than direct, how its population uses remittances.  The Mexican government should encourage the individual investment of remittances through improving its domestic banking infrastructure and incentivizing investment in small businesses in order to reduce its national asset-based poverty rate.

Many Mexican immigrants to the United States send money home to help support family members left behind, and this practice is so common that an estimated 5.4 million Mexicans receive money from relatives employed north of the border.[1] As of 2010, remittances represent the second largest source of foreign currency income in Mexico (behind oil revenue),[2] so even with recent declines in net amounts sent due to the global recession, these funds represent significant income for Mexico's economy. This money is also significant for individual families, particularly the estimated 46% of Mexico's population struggling with poverty. Poverty reduction of any magnitude could have a particularly strong effect in Mexico, where the lack of ability to meet basic living requirements creates a population vulnerable to cartels and organized crime.

But are remittances really aiding the Mexicans that receive them, helping to lift them out of poverty? President Calderon has stated that poverty reduction is one of his top economic priorities,[3] and given the importance of remittances to the Mexican economy, it stands to reason that this money could play a role. Currently, the Mexican government has a "Tres por Uno" program, in which they contribute $MX3 for every $MX1 in remittances donated toward hometown village projects.[4] Yet evidence exists that this program has not achieved any measurable decline in Mexico's 46.2% asset-based poverty rate.[5] Instead of this type of government intervention, attempting to direct remittance funding toward public

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[1] 5.4 million is the estimated number for 2011, from Juan Luis Ordaz Diaz, "Economic Watch: Mexico," Banco Bilbao Vizcaya Argentarias (BBVA), August 4, 2011: 2.
[2] See FoxNews Latino, "Remittances to Mexico up marginally in 2010," February 2, 2011, Mexico City, available at http://latino.foxnews.com/latino/money/2011/02/02/remittances-mexico-marginally/ .
[3] As stated in CIA World Factbook, https://www.cia.gov/library/publications/the-world-factbook/geos/mx.html
[4] Covadonga Meseguer and Javier Aparicio, "The Political Economy of Collective Remittances: The Mexican 3x1 Program for Migrants," Centro de Investigación y Docencia Economicas (CIDE), 2009. Available at: http://citation.allacademic.com/meta/p_mla_apa_research_citation/3/6/1/9/3/p361930_index.html?phpsessid=5b30ea07207e184dad845b09a3949b98
[5] Poverty rate as of 2010, from Consejo Nacional de Evaluación de la Política de Desarrollo Social (Coneval), available at http://internet.coneval.gob.mx/Informes/Interactivo/interactivo_nacional.swf

works projects, President Calderon should consider a different policy towards remittances that shows greater promise for lifting his citizens out of poverty. The Mexican government should encourage the individual investment of remittances through improving its domestic banking infrastructure and incentivizing investment in small businesses in order to reduce its national asset-based poverty rate.

**Poverty in Mexico**

Defining poverty in Mexico is no simple matter. The official government definition is multidimensional, so there are various levels depending on what basic needs an individual can meet. The broadest definition is asset-based, and describes a situation when an individual cannot cover food, health care, education, clothing, housing, and public transportation costs. The next tier is capabilities-based poverty, when a person cannot afford food, health care, and education. The most extreme definition of poverty relies on the parameters established by the World Bank for "extreme poverty", meaning that a person lives on less than $1.25 a day and cannot meet "minimal basic food needs."[6] Yet this definition has created controversy, and academics and policymakers have debated whether or not it is the "right" metric for capturing the scope of the problem. Another issue with this (or any other metric) is the necessary arbitrary cut-off: someone living on $1.26 a day does not fall into this category of "extreme poverty", but few would argue that they are not extremely poor. To minimize the impact of arbitrary cut-offs and to ensure that potential solutions address the bulk of the problem, this study is concerned with the broadest, asset-based definition of poverty.

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[6] Oscar Javier Cárdenas Rodríguez ,"Poverty Reduction Approaches in Mexico Since 1950: Public Spending for Social Programs and Economic Competitiveness Programs," *Journal of Business Ethics* (2009) 88: 274.

Who are the poor in Mexico? Largely, they are rural dwellers who reside in southern provinces of Mexico. The Economics Section of the U.S. Embassy in Mexico City reported that the poverty rate in Chiapas, Mexico's poorest state, was 76.7% in 2009.[7] Wealth in Mexico is concentrated in the capital city and in northern states along the U.S. border. As a general trend, the farther south one travels in Mexico, the poorer the population becomes. The states of Chiapas, Oaxaca, and Guerrero are the poorest in the country, and residents here earn, on average, no more than $5,200 USD per year.[8] Poverty rates vary geographically, so it is important that policies go beyond the federal level and into specific municipalities to fully address the issue.

Yet federal figures are useful in presenting the macro scope of the problem. Overall, in Mexico as a whole, asset-based poverty was 46.2% in 2010, down only .8% from the rate in 2008. This shows that the rate has basically stagnated, which is of concern. Of course, the period from 2008-2010 reflects a time of global recession, so the stagnation may represent an anomaly due to these tough economic years. But the high overall asset-based poverty numbers show that the problem is real, and there is undeniably a large percentage of the Mexican population struggling to afford the basic necessities of life.

**Remittance Spending**

Remittances from family members who have migrated (legally or illegally) to the United States are an important source of income for many of those in asset-based poverty. Perhaps not surprisingly, data shows that families spend the majority of remittances received on consumption; essentially, meeting these basic needs of food, clothing, shelter, etc.

[7] U.S. Embassy, Mexico City, Economics Section, "Mexico: Poverty at a Glance," January 2010. Available at: http://photos.state.gov/libraries/mexico/310329/20jul11/Fact_Sheet_Poverty_2010.pdf
[8] Ibid.

According to the Banco de Mexico, in 2007, Mexicans spent 86% of remittances revenue on consumption, and invested only .6% (in either commercial operations or community improvement).[9] Any money not spent was saved; but not in banks. Those who receive remittances keep their savings in cash (the proverbial "stuffed under the mattress") as a sort of insurance policy for future medical emergencies, unemployment, or for old age.

Spending remittance funds on consumption, while helpful for meeting day-to-day needs, offers little to no protection against future vulnerability to poverty. It is a short-term solution, as many studies have shown, and the least productive use of income when the goal is growth and sustainable development.[10] So the question becomes one of how to encourage remittance recipients, most of whom are poor, to save and invest rather than to spend the majority of their meager income on their immediate needs. It is not an easy idea to sell to people living hand-to-mouth, but Mexican policymakers have developed a program to address this issue and encourage community investment.

**Social Programs: "Tres por Uno"**

The existing "Tres por Uno" program, (where the Mexican government contributes $MX3 for every $MX1 remitted for development projects) directs remittance investment collectively toward public work projects. In many ways, it is an innovative program that began in 2002 to partner government entities at the federal, state, and municipal levels with Mexicans residing in the United States.[11] These Mexican immigrants form official

[9] Banco de México, 2007. 'Las remesas familiares en México. Inversión de los recursos de migrantes: resultados de las alternativas vigentes'. Mexico City: Banco de Mexico.
[10] See, for example, Benjamin Rempell, "Leveraging Migrant Remittances to Mexico: The Role for Sub-National Government" *Journal of Development and Social Transformation*, Vol. 2 (November 2005): 69-78.
[11] Although the Tres por Uno Program officially began in 2002 under President Vincente Fox, earlier, more localized versions of the concept had occurred since 1986, when the state of Zacatecas began a 1x1 Program. See Covadonga Meseguer and Javier Aparicio, "The Political Economy of Collective Remittances: The

Hometown Associations (HTAs) that unite to send money back to their communities of origin (where their contributions are matched at a one-for-one rate by federal, state, and municipal governments; hence the "3–for-1" overall ratio), and they retain an active voice in the designation of the projects selected to receive funding. Between 2002 and 2006, a total of 6,121 projects in 373 different municipalities were completed under this program.[12]

But there are several problems with this Tres por Uno program. First, its scope is very small: the federal government of Mexico provided only USD$15 million a year, on average, between 2003 and 2006.[13] As noted by a researcher from the Overseas Development Institute, this is a small amount when compared to the USD$63 million that migrants sent back to Mexico in 2006 on a *daily* basis.[14] More recent figures show that while the federal government has roughly doubled the funding available to the Tres por Uno program in 2008 and 2009, the federal money dedicated remains at less than USD$40 million per year.[15] So the Tres por Uno program does not have the benefit of the large funding it would need to increase the scope of its impact, and this is reflected in the fact that it has not achieved any significant declines in poverty rates since its inception. Mexico needs a more effective means of utilizing this remittance funding to impact poverty.

Data also shows that the Tres por Uno program has created problems in the regions receiving the projects, as buildings are often not completed, or completed but non-functional,

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Mexican 3x1 Program for Migrants," *Paper presented at the annual meeting of the Midwest Political Science Association 67th Annual National Conference, The Palmer House Hilton, Chicago, IL*, Apr 02, 2009: 11-13. Available at: http://www.allacademic.com/meta/p361930_index.html. See also Alina Rocha Menocal, "Programa 3x1 para Migrantes," Social Cohesion Practical Experiences and Initiatives, Coordination Office of EUROsociAL - FIIAPP and Overseas Development Institute (ODI), available at: http://www.odi.org.uk/resources/details.asp?id=1283&title=programa-3x1-para-migrantes

[12] Menocal, 4-5.

[13] Ibid, 5.

[14] Menocal, 5

[15] See Gobierno Federal, SEDESOL, "The 3x1 Program for Migrants" 2011. Available at: www.au.int/en/sites/default/files/Mexico_2.pdf

because state and migrant money runs out.[16] For example, in Los Cerritos, Mexico, a new old-age home stands empty: the project designers did not allocate money for staffing, or for maintenance and upkeep.[17] Lastly, statistics show that 28% of projects funded by the Tres por Uno program are "social" in nature, meaning they support items such as town beautification or sports centers.[18] While these can have economic benefit to communities, their rate of return is usually far less than that of public infrastructure projects such as paved roads, sewer systems, and other basic public goods. The Tres por Uno program has invested in many of these public good projects as well, but has yet to see measurable impact on poverty rates from these expenditures, whose payoffs are admittedly long-term in nature. But this again points to the need for a remittance policy that has a more direct impact on reducing the asset-based poverty rate in Mexico.

Of course, social programs that help the poor such as Tres por Uno are a necessary part of the Mexican government's response to the dire economical conditions that many of its citizens face. Government-funded programs such as *Opportunidades* have provided poor Mexicans with cash in return for ensuring their children remain in school and keeping regular health care appointments for the family.[19] This allows for the development of an educated, healthy workforce; in essence, it is a long-term investment in human capital. The Mexican government originally envisioned the *Opportunidades* program to be part of a holistic approach to reducing poverty – but they did not implement the complementing economic and political reform programs. As a result, those that graduate from the program "find

[16] See, for example, Sarah Lynn Lopez, "Migrant Remittances and the Mexican State: An Emergent Transnational Development Model?" ISSC Fellows Working Papers, Institute for the Study of Social Change, UC Berkeley, 20 July 2009. Available at: http://escholarship.org/uc/item/58k8g8zm
[17] Ibid., 31. Lopez visited five empty old-age homes in 2008, all built with Tres por Uno money.
[18] Meseguer and Aparicio, 23.
[19] U.S. Embassy, Mexico City, Economics Section.

themselves healthier and better educated, but still unemployed."[20] This highlights the necessity of implementing an integrated policy toward poverty reduction; if this is absent, poverty rates will not measurably decrease, despite individual program "successes." The proper metric is not number of educated, healthy Mexicans, but rather the increased income they are able to achieve with these advantages. When considering programs to increase the impact of remittances, this integrated, strategic view is important for policymakers to keep in mind.

So if directing remittances toward social programs had not reduced poverty rates, what can the Mexican government do? Research has shown that economic growth lowers poverty rates, and that a competitive economy positively contributes to this growth.[21] There is wide consensus among development economists that financial institutions play a crucial role in the process of economic development.[22] But to position poor Mexicans to benefit from this competitive economy, the government needs to set the stage via improvements to both its financial infrastructure and its small business loan environment.

**Improving Financial Infrastructure: Transmittals**

First, the improvement in the financial infrastructure component consists of two parts: one, easing the transmittal of remittances, and two, improving access of the Mexican poor to the banking system. First, to facilitate the transmittal of remittances, the Mexican government should work with the U.S. government to harmonize regulations governing remittances within each country for all transfer companies – a recommendation made by a

[20] Ibid.
[21] See Oscar Javier Cárdenas Rodríguez , "Poverty Reduction Approaches in Mexico Since 1950: Public Spending for Social Programs and Economic Competitiveness Programs," *Journal of Business Ethics* (2009) 88: 270 and 278.
[22] Christian Ambrosius, "Are Remittances a 'Catalyst' for Financial Access? Evidence from Mexico." Proceedings of the German Development Economics Conference, Berlin (2011): 5, Verein für Socialpolitik, Research Committee Development Economics.

2005 World Bank study that still requires implementation.[23] A 2004 study found that the majority of Mexican immigrants used remittance companies – not banks – to send money home,[24] and additional analysis showed that uneven regulation of these transfer companies distorted competition and added unnecessary costs.[25] For example, extreme differences in licensing requirements (both bonding and net worth) within individual states in the United States create a variance in transmittal company costs, which gets passed on to consumers.[26] On average, a Mexican remitting money back to their family sends USD$300 per month, and transmittal fees take about 6% of that sum.[27] While this fee has fallen from highs of 15% a decade ago thanks to increased competition and information, standardized regulation could increase transparency and thus level the competitive playing field, acting to decrease the price still further.[28] Mexico is not the only country that receives remittances sent from the United States, and so working with the U.S. government to standardize regulations for transmittal companies could benefit a larger immigrant population – something that Mexican policymakers should emphasize when negotiating this issue with their counterparts in the United States.

But more than the transmittal regulatory structure, Mexican access to this service on both the U.S. and Mexican side of the border is still an issue. In the United States, many

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[23] Dilip Ratha and Jan Riedberg, "On Reducing Remittance Costs," World Bank, Washington, D.C., May 25, 2005: 23-24. Available at: http://siteresources.worldbank.org/INTPROSPECTS/Resources/Onreducingremittancecosts-revisedMay12.pdf

[24] Manuel Orozco, "The Remittance Marketplace: Prices, Policy and Financial Institutions," Institute for the Study of International Migration, The Pew Hispanic Center, June 7, 2004: 8. Available at: http://pewhispanic.org/reports/report.php?ReportID=28

[25] Ratha and Riedberg, 23.

[26] Ibid.

[27] Data from The World Bank International Finance Corporation (IFC), available at: http://remittanceprices.worldbank.org/

[28] Empirical evidence shows that an increase in competition generally decreases price and improves service quality. See Ratha and Riedberg, 16 and Manuel Orozco, "Attracting remittances: Market, money and reduced costs," Report commissioned by the Multilateral Investment Fund of the Inter-American Development Bank, January 28, 2002. Available at: www.iadb.org/document.cfm?id=35075666.

Mexicans fear the documentation requirements banks will demand for these ETF transfers, even with the widespread acceptance of the Mexican *matricula consular*, an identity card issued by consulates as a legitimate form of identification that received widespread usage after 9/11 and the passage of the Patriot Act in the U.S.[29] While this reluctance is understandable among illegal immigrants, even those legally residing in the U.S. have expressed fear and uncertainty about their rights, particularly in light of many recent state laws regarding immigration policy (such as Arizona, which has recently denied recognition of the consular card altogether) [30] and often do not want to risk exposing themselves or a family member to increased scrutiny by federal or state agents as a result of sending money home.[31] Because of this, many Mexicans rely on personal word-of-mouth connections and cultural familiarity to select a transfer agent[32], and may willingly pay additional fees. As with any purchase, often price alone is not the sole determining factor.

On the Mexican side of the border, the government could improve recipient's access to electronic fund transfer (ETF) distribution points with lower cost options for obtaining the money sent to them. For example, recipients in rural areas often have to pay high transportation costs to collect their transfers in the "preferred" fashion – in cash.[33] (The complete costs of this lack of access will be discussed in greater detail below, in the section on Mexico's "unbanked".) This creates additional expenses, and reduces the amount of remittance money that they can spend on (or save for) other items.

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[29] Manuel Orozco, "The Remittance Marketplace: Prices, Policy, and Financial Institutions,":20.
[30] See Tom Ramstack, "Arizona Law Denies Recognition to Mexican Consular Identification Cards," *All Headline News*, Pheonix, Arizona, July 21, 2011. Available at: http://www.allheadlinenews.com/articles/90054930
[31] See Raul Hernandez-Coss, *The U.S.-Mexico Remittance Corridor: Lessons on Shifting from Informal to Formal Transfer Systems*, The World Bank Working Paper No. 47, Washington, D.C, 2005: 66-67.
[32] Ibid, 13.
[33] Lenora Suki, "Competition and Remittances in Latin America: Lower Prices and More Efficient Markets," Inter-American Development Bank and Organisation for Economic Co-Operation and Development, February 2007: 12. Available at: www.oecd.org/dataoecd/31/52/38821426.pdf

One caution in facilitating the transfer of remittances is the potential for abuse of the transfer system by criminals, terrorists, or cartels. The challenge is how to protect immigrant access to electronic remittance transfers while preventing these conduits from being used for criminal or terrorist activity. One way in which to do this is to limit the amount of money sent via ETF. The thought process is that legitimate migrant supporting families in Mexico will only send small amounts (roughly USD $326) per month, and that putting a limit on the transfer amount (USD $1000 per month) could created a barrier to cartel or other criminal network activity. These illegal elements would not get sufficient monetary throughput based on their effort, and would be deterred by the need for many small, undetectable transactions. The ability to trace EFTs should also serve as a deterrent to criminals, although it could potentially scare Mexican migrants (particularly illegals) as well.

**Improving Financial Infrastructure: Access for the "Unbanked"**

Within Mexico, many recipients of remittance funds do not have an inexpensive, dependable means of receiving the money sent to them. That leads to the second financial infrastructure issue that the Mexican government can address: increasing access of the "unbanked" to formal financial institutions. Currently, less than 25% of Mexicans possess even a simple checking account, and this lack of financial access carries steep costs.[34] For example, cashing paychecks requires up to 10% of income – a heavy burden for individuals dependent on daily wages.[35] Paying bills in cash takes more time, carries risks to personal security and entails transportation costs, not to mention the opportunity cost of missed work

[34] Edward C. Skelton, "Reaching Mexico's Unbanked", Federal Reserve Bank of Dallas, Vol. 3, No. 7 July 2008, available at http://dallasfed.org/research/eclett/2008/el0807.html
[35] John P. Caskey, Clemente Ruíz Durán, and Tova Solo, "The Unbanked in Mexico and the United States." Paper presented at the International Conference on Access to Finance, World Savings Banks Institute in association with the World Bank, October 28–29, Brussels,.April 2004: 41.

time. Yet Mexico's unbanked cite high barriers to financial system access: 70% list high fees and minimum balance requirements as the key reasons why they cannot – or do not – establish bank accounts.[36] The chart below shows how this stark lack of access to financial institutions is correlated to income, with the poor having little to no access to banking services.

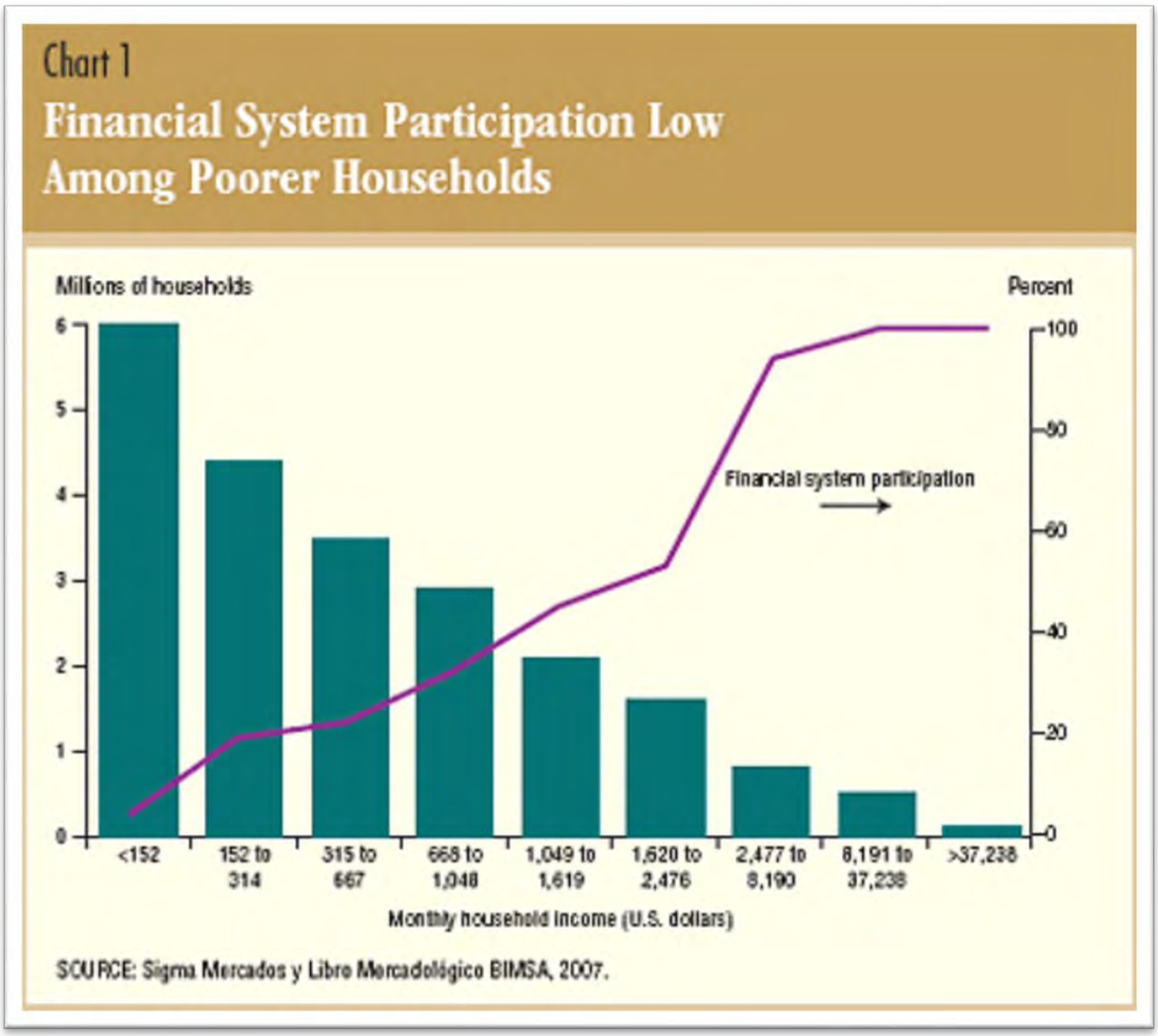


Chart from Skelton, "Reaching Mexico's Unbanked."

[36] Skelton.

Beyond hurting low-income households, a large, unbanked population creates costs to the financial system itself. For example, the Banco de México, the country's central bank, reports that "cash transactions cost the system up to five times more to process than checks, which are, in turn, more expensive than electronic payments." [37] Much of this expense comes from the necessary human interaction inherent in cash transactions; a bank teller's time creates a labor cost that is reduced via check or electronic payments. So there is an incentive for financial institutions to reduce their costs through increasing access to electronic banking services among those who currently lack them.

In addition, geography plays a large role in access to banking services. There are 1,445 municipalities (roughly 14 million people) without access to formal financial institutions, and these are primarily in poor, rural, southern regions of Mexico.[38] This makes it difficult to access remittance money, and this population pays significant fees to get the funds sent to them by relatives in the United States, because they are not account holders. The poor individuals who most need the remittance money are ironically those who have the most difficulty accessing it.

To remedy this, there are several steps that the Mexican government can take to reduce the number of "unbanked" citizens. First, to improve access to banking services, the government needs to encourage the removal of barriers to opening domestic accounts. To do this, it should increase funding to the government-owned development bank, Bansefi (Banco del Ahorro Nacional y Servicios Financieros), which offers no-fee, interest bearing checking

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[37] Banco de México information, as reported in Tova Solo, "The High Cost of Being Unbanked," AccessFinance, The World Bank Group, February 2005. Available at: http://www1.worldbank.org/finance/html/accessfinance/022005/article1.htm

[38] Skelton.

with initial deposits as low as 50 pesos (about $4.90).[39] Increased funding will allow Bansefi to expand both its advertising and presence, which should allow it to reach even more of the currently "unbanked".

Secondly, the government of Mexico should encourage banking partnerships with retail stores. In 2002, Grupo Elektra, a retailer specializing in sales to low-income consumers, developed Banco Azteca.[40] By March 2008, Azteca had grown to 1,121 branches, and boasted 6,254,981 account holders.[41] The government should offer incentives to banks to partner with other retailers to replicate this model, because retailers existing storefronts allow them to open bank branches quickly and cheaply. This offers a very cost-effective way to increase number of banks in rural areas that are underserved. Customers are also already familiar with the store, and so this should lower cultural barriers to entry because the storefront is already a known entity where they are comfortable conducting business.

If the government incentivizes banks to partner with retailers, this should spur competition, which should have beneficial effects for consumers across the banking sector. Studies have shown that sectors with economic competition and no monopolies are more sensitive to consumer price demands and respond more quickly to pressures to offer a competitive price. This is the classic laissez-faire model of the marketplace, espoused by Adam Smith and modified by Milton Friedman, which advocates the ability of the marketplace to correctly price goods and services at the intersection of the supply and demand curves.

Finally, to increase access to financial services, the Mexican government should look to the model offered by some Asian and African countries (such as the Philippines and

[39] Ibid.
[40] Ibid.
[41] Ibid.

Kenya) which make use of mobile phone banking to transfer funds. For example, in the Philippines, migrants can send remittances using a cell phone operated by a pre-paid card. These cell phone cards can store money, operating as an electronic transfer device, and consumers in the Philippines can use these cards in many shops to make purchases. This virtual system is efficient, as it gives recipients instant access to their money as well as a means of spending it directly on goods.[42] Of course, a telecom infrastructure is a requirement for this system to work effectively, and Mexico's is rather robust, with about 44% of the population having access to mobile technology.[43] Again, the government must take precautions to prevent criminal elements from taking advantage of this mobile transfer technology, but limiting card amounts should raise the time/effort costs for cartels and thus restrict their use of this means of money transfer or laundering.

**Incentivizing Investment**

Second, the Mexican government must incentivize using remittance money for investment rather than consumption. Currently, large corporate monopolies may be holding Mexico back from further development. According to a 2009 book published by the World Bank, special interest groups, in an attempt to preserve privileges built up over decades, are preventing competition, which would make their economy more efficient and productive.[44] So, in order to increase the level of development, the government of Mexico must create alternatives; namely, through encouraging the development of small and mid-sized

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[42] Ratha and Riedberg, 13.

[43] Kas Kalba, "The Adoption of Mobile Phones in Emerging Markets: Global Diffusion and the Rural Challenge," prepared for 6th Annual Global Mobility Roundtable 2007, Center for Telecom Management, Marshall School of Business, University of Southern California, Los Angeles, June 1-2, 2007:16. Available at: http://stage.marshall.usc.edu/assets/006/5577.pdf

[44] Santiago Levy and Michael Walton, eds. *No Growth Without Equity? Inequality, Interests, and Competition in Mexico*, World Bank and Palgrave Macmillan, New York: 2009. See also, Elisabeth Malkin, "Are Monopolies Holding Mexico Back?" New York Times, June 2, 2009. Available at: http://economix.blogs.nytimes.com/2009/06/02/monopolies-holding-mexico-back/

businesses by allowing these individual entrepreneurs greater access to the credit market. Even while Banco Azteca has added more than 6 million people to the formal financial system, the average interest rate it charges for credit is still high. And a case study of Compartamos, a for-profit microfinance provider, revealed that the actual rate charged to the borrower is 129% per year, while the rate marketed to clients is a mere 4% per month.[45] Clearly, the low-income population in Mexico still needs more affordable options for credit.[46]

The growth potential in this sector is significant: according to the International Finance Corporation, approximately 20% of Mexican businesses, and only 11% of microbusinesses, have accessed the formal financial system.[47] Once small businesses gained access to capital, they generated an estimated return of 20-33% on the funding received.[48] This is a phenomenal rate, and lenders should take note of the profitability of these loans. In this regard, remittances present an opportunity: if the government can encourage increased investment of these funds in small business ventures, they will help both the poor citizen and the economy as a whole. To do this, the government must encourage micro-financing, and regulate the predatory actions seen in the domestic micro-financing market. By using local-level targeting focused on those who receive remittances, the government can provide information about low cost options to those seeking loans. This information campaign would

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[45] See Chuck Waterfield, "Explanation of Compartamos Interest Rates," 19 May 2008. Available at: http://www.microfin.com/files/Explanation%20of%20Compartamos%20Interest%20Rates%2019May.pdf . See also Richard Rosenberg, Adrian Gonzalez, and Sushma Narain, " The New Moneylenders: Are the Poor Being Exploited by High Microcredit Interest Rates," CGAP, World Bank, Washington, D.C., 2009.

[46] Xavier Faz and Paul Breloff, "Mexico: Promising Moves Toward New Banking Models," Consultative Group to Assist the Poor (CGAP), April 27, 2011, available at: http://technology.cgap.org/2011/04/27/mexico-promising-moves-towards-new-banking-models/

[47] Skelton.

[48] See Robert Cull, David McKenzie and Christopher Woodruff , "Experimental Evidence on Returns to Capital and Access to Finance in Mexico," World Bank, Feb. 12, 2007.

increase transparency in the loan marketplace, which would address a major failing of the system thus far.

Some other financing options do exist. Unregulated finance companies, known as sofomes (Sociedades Financiera de Objeto Múltiple), are a relatively new entrant into the lending landscape. With no ability to accept deposits, these sofomes are also not subject to rules established by the national banking commission, which many have described as overly regulated and creating high startup and compliance costs.[49] This enables sofomes to enter markets that big banks avoid to do low potential for returns, such as the agricultural industry and micro to medium-sized businesses.[50] Of course, the obvious drawback to sofomes is exactly this unregulated nature, which offers the potential for abuses to continue undetected. Currently, due to corruption, 78% of the formal economic sectors are infiltrated by organized crime,[51] so any unregulated financial entity presents a concern. Still, these companies bear watching, and the government should capitalize on them by creating policies to help sofomes increase their ability to lend to small, developing entrepreneurs.

One way to do this would be to adapt the business model of kiva.org, a microcredit organization which uses person-to-person financing, with modifications to reflect the role that sofomes play in the lending market. Kiva.org uses the internet and intermediary companies ("field partners") in various countries to connect lenders with poor entrepreneurs who lack access to traditional sources of credit.[52] The program has proven that the poor are capable of borrowing money, developing successful entrepreneurship ideas, making regular

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[49] Skelton.
[50] Ibid.
[51] Samuel Logan, "Mexico's Dirty Cash," International Relations and Security Network (ISN) Security Watch, Swiss Federal Institute of Technology, Zurich, 20 April 2009, available at: http://www.isn.ethz.ch/isn/Current-Affairs/Security-Watch-Archive/Detail/?id=99115&lng=en
[52] See http://www.kiva.org/about for additional information about the company's lending process.

repayments, and successfully completing a full lending–borrowing cycle.[53] The Mexican government could allow sofomes to mirror the communications structure of kiva.org, and encourage immigrants to serve as donors, loaning some of their remittance money to individuals attempting to start businesses in their home communities. This is a very different model than the current Tres por Uno program in that it allows for support of individual micro-businesses – something prohibited under the collective Tres por Uno model.

**Conclusion and Recommendations**

The key to increasing access to financial institutions and small-business loans lies in the ability of these venues to have an impact on poverty reduction. Hernando de Soto has argued that access to capital and to financial services is the key to economic growth both in advanced economies and in the developing world.[54] So it stands to reason that increasing such access will increase economic growth. But the challenge then becomes ensuring that this growth benefits the poor as well as the other segments of society; if it serves to increase, rather than decrease, economic disparity, it will not have achieved the intent. Remittances already offer hope for short-term poverty reduction. According to a recent study, the presence of remittances in a household "reduced its probability of being in food -based and in capabilities-based poverty by 7.7 and 6.3 percentage points, respectively."[55] The issue, then, is how to build on this short-term result and reduce future vulnerability to poverty. This is where the potential offered by Mexican policy changes comes into play.

[53] Gustavo Barboza and Sandra Trejos, "Micro Credit in Chiapas, Mexico: Poverty Reduction Through Group Lending," *Journal of Business Ethics*, Vol 88 (2009): 297-298.
[54] Cited in Caskey et. al., 3.
[55] Gerardo Esquivel and Alejandra Huerta-Pineda, "Remittances and Poverty in Mexico: A Propensity Score Matching Approach," *Integration and Trade Journal*, No. 27 (July-December 2007): 56.

A central component of development theory rests on the ability to achieve sustainable growth and poverty reduction. The argument presented here is that a lighter government hand, as part of an overall coordinated strategy emphasizing investment in small business, can produce an increased rate of effectiveness. Such success has the potential to snowball, and perhaps attract some Mexican migrants to return home. This "circular migration" should be a goal of Mexican policymakers, because these individuals represent valuable human capital, possessing the skills to help further develop the domestic economy.

Still, the Mexican government needs to be cautious to avoid unintended consequences, such as facilitated access of cartels to money laundering in the financial system, as mentioned here. But remittances have proven to offer a stable capital flow,[56] and thus deserve policymaker's attention. The art of managing them, though, lies in using a soft hand to shape, rather than heavily direct, this money to maximize its ability to reduce asset-based poverty.

This is a case where the Mexican government's ability to formulate an economic strategy can bring to bear that element of national power into the fight against the cartels that threaten the government's sovereignty. By formulating policies that encourage the investment of steady remittance income into micro-entrepreneurial business ventures, the government can positively affect long-term economic growth and decrease the stubborn asset-based poverty rate by presenting opportunities for people to gain social and economic mobility. And if Mexico can grow a larger middle class, then it also will create a less-vulnerable population, which will ultimately benefit state security.

The government must initiate this economic policy with this strategic objective in mind. And often, these first strategic policy steps are difficult – not necessarily to initiate,

[56]Ambrosius, 4.

but to sustain. Mexico currently has an amalgam of economic policies that lack unity, and so the government has not realized its stated objective of poverty reduction. With an overall policy vision of reliance on the individual, entrepreneurial, capitalistic spirit, the Mexican government can shape the use of remittances to affect this change.

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